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Subordinated debt repayable only out of future profits not generally a liability

The Supreme Tax Court has ruled that qualified subordinated debt is not a liability if it is only repayable out of future profits or in case of a possible liquidation surplus.

In its decision the Supreme Tax Court revealed on how it sees qualified subordinated debt in the tax accounts of the debtor in the light of the Income Tax Act provision excluding recognition of liabilities only repayable out of future profits.

The case before the court involved a loan granted to a company by its sole shareholder. Both were public limited companies (GmbH) and the subsidiary was heavily indebted. In light of this it was mutually agreed that repayment of the loan only be made from future profits or any liquidation surplus. The tax office disallowed the liability on the grounds of the relevant provision in the Income Tax Act.

The Supreme Tax Court confirmed the validity of the Income Tax Act and held that the liability be released to income. The subordination was comparable to an improvement clause restoring the rank of the debt in the event of surpluses. A debt must be recorded in the accounts only if the claim for repayment is in any way likely and enforceable. This was not the case here and the debt was thus to be invalidated for tax purposes, since - absent of any profits at balance sheet date - the debtor could not in any way be obliged to repay and would therefore not suffer financial encumbrances in any way. (mh)

Supreme Tax Court judgment I R 100/10 of November 30, 2011 - published on February 29, 2012

Schlagwörter

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